

CORPORATE AND SECURITIES LAW

Alert

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

SEC Adopts Final Executive and Director Compensation Disclosure Rules

July 27, 2006

As many of you may have heard, in an open meeting yesterday (July 26, 2006), the Securities and Exchange Commission (“SEC”) unanimously approved in part the final rules relating to executive and director compensation disclosure and revised and repropounded the provisions requiring disclosure of the compensation for up to three non-executive employees who earn more than any of the company’s named executive officers. According to the SEC, a record number of comment letters, over 20,000, were submitted on the proposed rules.

The text of the rules is not yet available and, as a result, the following overview is based on the discussions at the open meeting and a subsequent SEC press release. For the most part, the final rules approved were substantially the same as the proposed rules described in an earlier memo (see, *SEC Proposed Rules On Executive and Director Compensation Disclosure* at www.bassberry.com), with the following key differences:

Rule Requiring Disclosure of Compensation Paid to Non-Executive Officers to be Revisited

The so-called “Katie Couric rule” requiring disclosure of the compensation paid to up to three non-executive officers whose total compensation was in excess of the total compensation paid to any of the company’s named executive officers was not included in the final rules adopted yesterday; however, it will be revised and repropounded for public comment. The revised proposed rule, which will only apply to large accelerated filers (or companies with a market capitalization of more than \$700 million), would require disclosure of the total compensation and job description of the three most highly-compensated employees (whether or not they are named executive officers) whose compensation for the last fiscal year exceeded that of any named executive officer, if the employee had responsibility for significant policy decisions within the company, a significant subsidiary, or a principal business unit, division or function.

More Extensive Disclosure Required of Option Granting Practices

Perhaps the most noteworthy change from the proposed rules is the focus on option grant practices. In response to the recent focus on stock option timing issues, the final rules will require clear tabular

disclosure of stock option grants, including (i) the FAS 123R grant date, (ii) the FAS 123R grant date fair value, (iii) the closing market price on the grant date if it is greater than the exercise price of the award and (iv) the date the compensation committee or full board of directors took action to grant the award if that date is different than the grant date. Further, if the exercise price of an option is not the grant date closing market price, the company will be required to describe the methodology used for determining the exercise price.

The new Compensation Discussion and Analysis (“CD&A”) section will also require enhanced narrative disclosure regarding option grants to executives. This section will require companies to analyze and discuss material information relating to their option grants, including the reasons the company selects particular grant dates for awards and the methods the company uses to select the terms of their awards, such as the exercise prices of stock options. Companies will also be asked to discuss any plans, programs or practices they have with respect to the timing of option grants in coordination with the release of material non-public information. Companies will have to provide similar disclosure if they have a program, plan or practice of awarding options and setting the exercise price based on the stock's price on a date other than the actual grant date or if they set the exercise price of option grants by using formulas based on average prices (or lowest prices) of the company's stock in a period preceding, surrounding or following the grant date.

The CD&A and the Compensation Committee Report

As originally proposed, the CD&A will be “filed” as opposed to “furnished,” thus requiring the company’s chief executive officer and principal financial officer to certify to the accuracy of the CD&A. The final rules as adopted will also require the addition of a new Compensation Committee Report, similar to the current Audit Committee Report, on which the chief executive officer and principal financial officer will be able to rely when making their certifications. This new report will be “furnished” rather than “filed” and will be placed over the names of the compensation committee members. This report will be required to state whether the compensation committee has reviewed and discussed the CD&A section with management and recommended that the section be included in the company's annual report on Form 10-K and proxy statement.

Performance Graph Retained

While the proposed rules would have allowed the CD&A section to replace the stock performance graph, the final rules will retain the performance graph requirement but uncouple it from executive compensation disclosure. The rules as adopted will require the graph to be included in the Annual Report to Shareholders, rather than in the proxy statement.

Limited Disclosure of Information Used by the Board in Making Independence Determinations

The proposed rules would have required companies to disclose any information considered by the Board in making independent director determinations that was not otherwise disclosed. The final rules will only require the disclosure of a description, by category or type, of any transactions, relationships or arrangements not disclosed as related party transactions considered by the Board members in making their independence determinations.

Change of Control and Termination Benefits

Like the proposed rules, the final rules will require a description and quantification of termination and change of control payments to named executive officers. However, the final rules will provide guidance as to the assumptions that should be applied in calculating such amounts. Specifically, the final rules will require the assumption that the triggering event took place on the last business day of the company's immediately preceding fiscal year and, to the extent relevant for the calculations, that the price per share of the company's stock was the closing market price on such date.

Other Changes to the Proposed Rules

- In a change from the proposed rules, the SEC indicated that dividends on restricted stock will not be considered compensation reportable in the Summary Compensation Table so long as dividends were included in determining the disclosed FAS 123R fair value of the award.
- Unlike the proposed rules, the final rules appear not to require inclusion of at-market and non-preferential earnings on nonqualified deferred compensation in the Summary Compensation Table.
- In a reversal from the proposed rules, the "named executive officers" in the proxy statement will be determined based on total compensation, excluding increases in actuarial present value of pension benefits and earnings on nonqualified deferred compensation.

Effective Date

The new rules will generally apply to next year's annual proxy statements for companies whose fiscal year ends on or after December 15, 2006 and to Securities Act registration statements filed on or after that date.

A copy of the SEC Press Release announcing the final rules can be obtained at <http://www.sec.gov/news/press/2006/2006-123.htm>.

If you have any questions about this Corporate and Securities Law Alert, or would like any additional information, please contact any Bass, Berry & Sims attorney in the Corporate and Securities Practice Area.

The materials contained herein have been abridged from the statutory sources and should not be construed or relied upon for legal advice. Readers are urged to consult legal counsel concerning particular situations and specific legal questions.

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